Monday, January 14, 2002

UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

In re

SULLIVAN & LODGE, No. 99-10501

Debtor(s).

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Memorandum re Fees of Special Counsel

I. Background

Debtor Sullivan & Lodge was in the business of bottling and selling spring water under the trade name Cobb Mountain Spring Water. It filed its Chapter 11 petition on February 16, 1999, after a downturn in its business.

The principals of Sullivan & Lodge believed that their business had been harmed by the unfair business practices of two competitors, Crystal Geyser Roxane Water Company and Great Springs Waters of America. Specifically, Sullivan & Lodge believed that these two competitors sold water to the public as "spring water" when it was not, and that their water exceeded permitted levels of toxins and contaminants.

Robert S. Jaret of the law firm of Jaret & Jaret was the prepetition general counsel for Sullivan & Lodge. After consulting with the principals of his client and an expert hydrologist, Jaret recommended associating the law firm of Lieff, Cabraser, Heimann & Bernstein, LLP, for the purpose of bringing an action against the competitors for unfair competition. The principals

agreed; on April 12, 1999, they signed an agreement for representation with Jaret & Jaret and Lieff Cabraser.

On April 14, 1999, Jaret & Jaret and Lieff Cabraser filed a lawsuit against the two competitors in state court. However, this lawsuit was not filed for Sullivan & Lodge. It was a class action lawsuit on behalf of customers of the two competitors. The named plaintiffs were a former employee of Lieff Cabraser and a friend of the Jaret firm's bookkeeper. Although the existence of this class action was never concealed from Sullivan & Lodge, neither law firm sought its permission to undertake it.

Through its bankruptcy counsel, Sullivan & Lodge sought court permission to employ the Jaret firm and Lieff Cabraser as special counsel pursuant to § 327(e) of the Bankruptcy Code on May 17, 1999. Philip Jaret filed a declaration is support of the application on behalf of his firm and William Bernstein filed one on behalf of Lieff Cabraser as required by FRBP 2014(a). Neither declaration mentioned anything about the class action. Both declarations represented to the court that there were no connections with the debtor other than those disclosed, and that the law firms had no interests adverse to the debtor. The court approved the application without any knowledge whatsoever of the class action and the dual representation of the proposed special counsel.

Both the unfair competition action and the class action were prosecuted by the two law firms in state court. There are indications that at one time one of the defendants was willing to pay Sullivan & Lodge $4.8 million, but only if the class action suit was also settled. Ultimately, the Jaret firm and Lieff Cabraser negotiated settlement of the class action first, including over $2 million for their fees. They then negotiated a settlement of the Sullivan & Lodge suit for $245,000.00, which was accepted by the Chapter 7 trustee, as the case had by then been converted to Chapter 7. The principals of Sullivan & Lodge objected, but later withdrew their objection without prejudice to their right to object to the fee applications of the Jaret firm and Lieff Cabraser. Those objections are now before the court.

II. Failure to Obtain Written Consent to Dual Representation

The ethical responsibilities of Lieff Cabraser and the Jaret firm were governed by Rule 3-310 of the California Rules of Professional Conduct. By any measure, both firms failed to live up to these responsibilities.

Rule 3-310(C)(1) requires an attorney to obtain *informed written consent* before accepting representation of more than one client in a matter in which the interests of the clients potentially conflict. The applicants here argue that they did not violate the rule because their decision to create a class action was approved and encouraged by Sullivan & Lodge, it was not the same matter, and there was no potential conflict of interest. None of these arguments have merit.

A. Tacit Approval

The evidence is clear and undisputed that while Sullivan & Lodge was told about the class

action, its written approval was never obtained and it was never told that it had a right to object to the dual representation. Informed written consent is required before an attorney can jointly represent clients in the same matter. Zador Corp. v. Kwan, (1995) 31 Cal.App.4th 1285, 37 Cal.Rptr.754. Current clients cannot impliedly consent to conflicted representation; a written waiver is required. Blecher & Collons, P.C. v. Northwest Airlines, Inc., 858 F.Supp 1442, 1454 (C.D.Cal. 1994).

If the principals of Sullivan & Lodge had been properly told that they had the right to veto the dual representation, they might have given the matter more thought or at least knowingly accepted the risk that their attorneys would devote more of their attention to the class action than the Sullivan & Lodge case. By denying them the opportunity, the Jaret firm and Lieff Cabraser violated their ethical obligations.

B. Same Matter

The Jaret firm and Lieff Cabraser seem to argue that Rule 3-310 is not applicable because the lawsuit on behalf of Sullivan & Lodge was a different matter than the class action. The court sees no merit to this position. Those counsel learned of the basis for the class action as a result of investigation undertaken on behalf of Sullivan & Lodge. While the legal claims may have been different, the underlying facts and conduct of the defendants giving rise to the claims were the same. In order to make Rule 3-310 applicable, there need only be a substantial relationship between the two representations. Elan Transdermal Ltd. v. Cygnus Therapudic Systems, 809 F. Supp. 1383 (N.D.Cal. 1992).

C. Conflict of Interest

Where an attorney undertakes simultaneous representation of clients, the primary value at stake is the attorney's duty and the client's legitimate expectations of loyalty. When measuring adverse representation one must look not so much to the similarities in the litigation, but to the duty of undivided loyalty the attorney owes to each of his clients. Forrest v. Baeza (1997) 58 Cal. App.4th 65, 67 Cal.Rptr.2d 587.

In this case, there was at the very least a potential risk that the representation of Sullivan & Lodge would become less effective by reason of the class action. Further, a careful review of the facts here has led the court to the firm conclusion that Sullivan & Lodge would have fared far better had the Jaret firm and Lieff Cabraser not undertaken the class action. Thus, there is a basis for a finding of an actual conflict.

The court feels compelled to comment on the essentially venal nature of class action lawsuits. This is not a situation where the two law firms found themselves in a dual representation situation while trying to do their best for two different clients. In this case, the law firms themselves concocted the class action and created the dual representation out of greed. In their desire to reap the large fees available in a class action, the Jaret firm and Lieff Cabraser failed to insure that Sullivan & Lodge received the undivided loyalty and commitment from them that it was entitled to have from them. *See* Truck Ins. Exchange v. Fireman's Fund Ins., (1992) 6 Cal.App.4th 1050, 1056, 8 Cal.Rptr.2d 228.

III. Failure to Disclose

Rule 2014(a) of the Federal Rules of Bankruptcy Procedure is intended to avoid situations like that now before the court. By disclosing all connections with the parties, the proposed counsel is supposed to allow the court to make an informed decision as to whether employment is to be allowed. By failing to mention any word of the class action, the Jaret firm and Lieff Cabraser did not allow the court to properly exercise its judgment. Had the class action been disclosed, the court would probably not have allowed the employment. At the very least, it would have insisted upon informed written consent.

A bankruptcy court has the discretion to sanction a firm for its mistakes. *See*, In re Film Ventures Int'l, 75 B.R. 250, 252 (9th Cir.BAP 1987). "Anything less than the full measure of disclosure leaves the counsel at risk that all compensation may be denied." In re Saturley, 131 B.R. 509, 516-517 (Bank.D.Me.1991) (citing In re Futuronics Corp., 655 F.2d 463 (2d Cir.1981). cert. denied 455 U.S. 941 (1982). While the Jaret firm and Lieff Cabraser would have the court believe that their failure to disclose the class action was an innocent mistake, the court has no doubt that the omission was intentional because counsel did not want to run the risk of disqualification. Nothing less than a complete forfeiture of all fees would be just in this case. If the court had the power, it would order disgorgement of the class action fees as well.

IV. Conclusion

The Jaret firm and Lieff Cabraser violated FRBP 2014(a) by failing to disclose their involvement in the class action and Rule 3-310 of the California Rules of Professional Conduct by failing to obtain the informed written consent of Sullivan & Lodge before undertaking the class action. There are no facts in mitigation. These lawyers clearly placed their desire for class action fees above their loyalty to their client, and deceived the court in the process. Accordingly, the court will sustain the objection to their fees and order them to disgorge to the Chapter 7 trustee all interim fees and expenses which they have received. Moreover, the order approving their employment shall be vacated as having been made upon the basis of deception and misrepresentation.

Counsel for the objecting parties shall submit an appropriate form of order.

Dated: January 14, 2002

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Alan Jaroslovsky

U.S. Bankruptcy Judge

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